REPORT OF

FINANCIAL EXAMINATION

**LYNDON PROPERTY INSURANCE COMPANY**

AS OF
December 31, 2003

STATE OF MISSOURI

DEPARTMENT OF INSURANCE

JEFFERSON CITY, MISSOURI

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September 6, 2005
St. Louis, Missouri

Honorable Kevin M. McCarty, Commissioner
Office of Insurance Regulation
Florida Department of Insurance
Chairperson, Financial Condition (E) Committee, NAIC

Honorable Jorge Gomez, Commissioner
Office of Commissioner of Insurance
State of Wisconsin
Secretary, Midwestern Zone, NAIC

Honorable W. Dale Finke, Director
Missouri Department of Insurance
301 West High Street, Room 530
Jefferson City, Missouri 65101
{ TC "SALUTATION"\l1 }
Gentlemen:

In accordance with your financial examination warrant, a full scope association financial examination has been made of the records, affairs and financial condition of

**LYNDON PROPERTY INSURANCE COMPANY**

also referred to as the "Company." The Company's administrative office is at 14755 North Outer Forty Road, Suite 400, St. Louis, Missouri 63017, telephone number (636) 536-5600. This examination began on December 29, 2004, and concluded September 6, 2005.

## SCOPE OF EXAMINATION

### Period Covered

The prior full scope association financial examination of Lyndon Property Insurance Company was as of December 31, 2000, and was conducted by examiners from the state of Missouri, representing the Midwestern Zone of the National Association of Insurance Commissioners (NAIC) and the state of Kentucky, representing the Southeastern Zone.

The current full scope association financial examination covers the period from January 1, 2001, to December 31, 2003, and was conducted by examiners from the state of Missouri representing the Midwestern Zone of the NAIC. The firm of Expert Actuarial Services, LLC, Consulting Actuary, pursuant to a contract with the Missouri Department of Insurance, reviewed reserves and related actuarial items.

This examination also included material transactions and/or events occurring after December 31, 2003.

**Procedures**

This examination was conducted using the guidelines set forth in the Financial Condition Examiners Handbook of the NAIC, except where practices, procedures and applicable regulations of the Missouri Department of Insurance and statutes of the state of Missouri prevailed.

The workpapers of the Company's independent auditors were made available to the examiners. Standard examination procedures were modified as deemed appropriate under the circumstances.

**Comments – Previous Examination**

The general comments and recommendations in the previous examination report and the Company's response and/or subsequent action taken by the Company are listed below.

1. Comment: It is recommended that the minutes document the declaration by the Board of Directors of all dividends before payment. The Company is also directed to report the dividends to the Missouri Department of Insurance on Form B immediately.

Company's Response: The Form B was prepared and sent to the Chief Financial Examiner with the Missouri Department of Insurance on July 9, 2002.

Current Findings: The Form B was sent to the Chief Financial Examiner on July 9, 2002.

2. Comment: The Company is directed to file a Form D with the Missouri Department of Insurance immediately notifying the director of its intent to enter into the Tax Allocation Agreement with Protective Life Corporation and its subsidiaries.

Company's Response: The Form D was prepared and sent to the Chief Financial Examiner with the Missouri Department of Insurance on July 30, 2002.

Current Findings: The Form D was sent to the Chief Financial Examiner on July 30, 2002.

3. Comment: The Company is directed to amend the annual statement immediately to correctly disclose the method of allocating federal income taxes.

Company's Response: The method of allocating federal income taxes was corrected in the 2001 annual statement as follows: The method of allocation is based upon separate return calculations. Any tax attribute of a member for which no benefit is given shall carry forward to the member's future separate return liability calculations.

Current Findings: The above method of allocation was included in note F of the Notes to Financial Statements in the 2001 annual statement.

4. Comment: The Company is directed to file a Form D with the Missouri Department of Insurance immediately notifying the director of its intent to enter into the Administrative Services Agreement with Western Diversified Services, Inc.

Company's Response: A Form D filing for the Administrative Agreement with Western Diversified Services, Inc. was mailed to Jeff Blume with the Missouri Department of Insurance on December 7, 2001 and filed with the Department on December 10, 2001.

Current Findings: The Form D was filed with the Missouri Department of Insurance.

5. Comment: The Company is directed to complete all the items on all the questionnaires immediately as requested by the Acting Chief Examiner. The completed questionnaires and related documentation should be submitted to the Audit Manager, St. Louis, Missouri Department of Insurance.

Company's Response: The items in the questionnaire were discussed with the Department's consulting actuary, Jon Michelson, during the examination. The questionnaire has been completed and was sent to the Audit Manager on August 27, 2002.

Current Findings: The Reinsurance Questionnaire was sent to the Audit Manager.

## HISTORY

### General

Lyndon Property Insurance Company was incorporated on May 30, 1978, as a stock casualty insurance company and commenced business on August 1, 1978. Until May 1995, the Company was wholly owned by ITT Financial Corporation, a wholly owned subsidiary of ITT Corporation. On May 1, 1995, ITT Financial Corporation merged with ITT Corporation.

On October 20, 1995, Mercury Finance Company acquired all the outstanding common stock of ITT Lyndon Property Insurance Company. On December 1, 1995, the name of the Company was changed to Lyndon Property Insurance Company.

In June 1997, Frontier Insurance Group, Inc. purchased all the outstanding common stock of the Company. In 1998, Frontier Insurance Group, Inc. formed a wholly owned subsidiary, Lyndon Insurance Group, Inc., and contributed all the outstanding stock of the Company to the wholly owned subsidiary.

On January 20, 2000, Protective Life Insurance Company, a wholly owned subsidiary of Protective Life Corporation, purchased all the outstanding common stock of Lyndon Insurance Group, Inc.

**Capital Stock**

The Company is authorized to issue 4,000 shares of common stock at a par value of $1,000 per share. There were 4,000 common shares issued and outstanding as of December 31, 2003, resulting in a common capital stock account of $4,000,000 and gross paid in and contributed surplus of $52,708,443.

**Dividends**

The Company has declared and paid dividends to stockholders as follows:

| | Cash | Stock |
|---|---|---|
| Through December 31, 2000 | $ 179,663,543 | $ 2,000,000 |
| 2001 | - | - |
| 2002 | - | - |
| 2003 | - | - |
| Total | $ 179,663,543 | $ 2,000,000 |

**Management**

The Board of Directors consists of six members duly elected at an annual meeting of the sole stockholder as authorized by the Company's Articles of Incorporation. In 2004, the number of directors was increased to nine in compliance with Section 379.035 RSMo (Stock insurers; articles of incorporation) requiring at least nine directors. As of December 31, 2003, all directors were also officers of the Company. The directors duly elected and serving as of December 31, 2003, were as follows:

| Name | Principal Occupation |
|---|---|
| Brent E. Griggs<br>St. Louis, Missouri | President, Chairman of the Board and CEO |
| Gregg O. Cariolano<br>St. Louis, Missouri | Senior Vice President, Chief Financial Officer, Controller and Treasurer |
| Mark S. Downar<br>Ballwin, Missouri | Assistant Secretary and Assistant Treasurer |
| Richard C. Hackett<br>Ballwin, Missouri | Senior Vice President and Secretary |
| Quentin D. McClung<br>Ballwin, Missouri | Senior Vice President, Product Management |
| C. Alan Miller<br>Chesterfield, Missouri | Senior Vice President, National Accounts |

Members of the executive committee of the Board of Directors as of December 31, 2003, were Brent E. Griggs and Gregg O. Cariolano.

The officers elected and serving as of December 31, 2003, were as follows:

| Name | Office |
|---|---|
| Brent E. Griggs | President, Chairman of the Board and Chief Executive Officer |
| Richard J. Bielen | Vice President, Investments |
| Gregg O. Cariolano | Senior Vice President, Chief Financial Officer, Controller and Treasurer |

| Name | Office |
| --- | --- |
| Jerry W. DeFoor | Vice President |
| Mark S. Downar | Assistant Secretary and Assistant Treasurer |
| Richard C. Hackett | Senior Vice President and Secretary |
| Lori A. Hallissey | Vice President |
| M. Scott Karchunas | Senior Vice President, Dealer Sales |
| Deborah J. Long | General Counsel |
| Quentin D. McClung | Senior Vice President, Product Management |
| William L. McMullen Jr. | Vice President, Secretary and Assistant Treasurer |
| C. Alan Miller | Senior Vice President, National Accounts |
| Thomas M. Presley | Vice President and Actuary |
| Carl S. Thigpen | Vice President, Investments |
| Steven G. Walker | Vice President |

**Conflict of Interest**

Conflict of Interest Disclosure Statements are executed annually by all directors and officers of the Company. A review of the statements for the years under examination indicated no material conflicts.

**Corporate Records**

The Articles of Incorporation and Bylaws of the Company were reviewed. Neither the Articles of Incorporation nor the Bylaws were amended during the period being examined.

The minutes of the meetings of the Stockholder and Board of Directors were also reviewed for the period under examination. The minutes appeared to properly document and approve applicable corporate events and transactions.

**Acquisitions, Mergers, and Major Corporate Events**

In September 2001, the Company purchased seventy percent of common stock of Insurance Company of the South for $2,450,000. The remaining thirty percent was held by Life of the South Insurance Company. In October 2004, the Company sold its seventy percent interest to Life of the South Corporation, the parent of Life of the South Insurance Company.

In June 2002, the Company sold its wholly owned subsidiary, Lyndon Life Insurance Company. Prior to the sale, the Company received a dividend from Lyndon Life Insurance Company that included all the outstanding stock of Acceleration Life Insurance Company and Lyndon Financial Corporation.

On February 20, 2003, the Company received a $4,341,975 capital contribution from its parent. The Company contributed the funds to its wholly owned subsidiary, Acceleration Life Insurance Company. In March 2004, the Company sold Acceleration Life Insurance Company.

**Surplus Debentures**

None.

## AFFILIATED COMPANIES

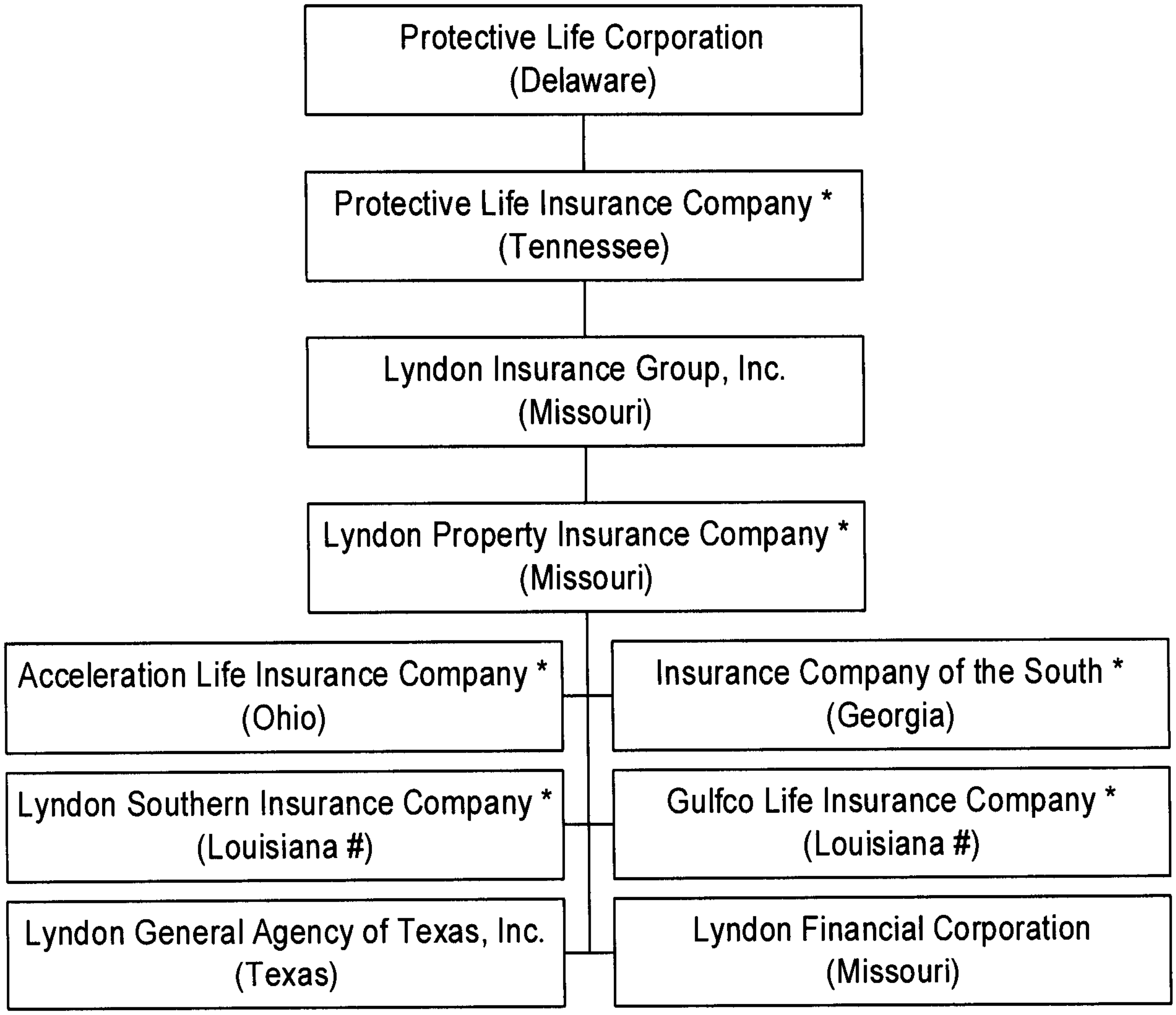
### Holding Company, Subsidiaries and Affiliates

The Company is a member of an Insurance Holding Company System as defined by Section 382.010 RSMo (Definitions). The ultimate controlling person is Protective Life Corporation, a publicly traded corporation listed on the New York Stock Exchange. Protective Life Corporation became the ultimate controlling person on January 20, 2000, when its subsidiary, Protective Life Insurance Company, purchased all the outstanding common stock of Lyndon Insurance Group, Inc.

### Organizational Chart

The following organizational chart depicts the Insurance Holding Company System as of December 31, 2003. The chart includes only the Missouri domiciled insurers, the Company, its parents and insurance company subsidiaries. A complete organizational chart is included in the Company's annual statement.

Lyndon Property Insurance Company owns 91% of Lyndon Southern Insurance Company, 91% of Gulfco Life Insurance Company and 70% of Insurance Company of the South. All other subsidiaries are wholly owned and insurance companies are identified with an asterisk.




# Pursuant to Louisiana Insurance Code, each director of a domestic insurer must own at least ten shares.

**Intercompany Transactions**

Effective January 20, 2000, the Company entered into the following intercompany agreements with its ultimate parent, Protective Life Corporation.

Agreement for Investment Services

The Company and Protective Life Corporation executed an Agreement for Investment Services effective January 20, 2000, under which Protective Life Corporation agreed to provide investment services required by the Company including but not limited to, the following: (i) to research and analyze investment opportunities; (ii) to execute purchases or sales pursuant thereto; (iii) to collect and transmit to the Company any amounts paid on such investments; (iv) to provide and maintain documentation which clearly and accurately discloses the precise nature of the investment transactions; and (v) to provide and maintain documentation necessary for the preparation of accounting records and any required reports needed monthly, quarterly, or as part of statutory annual filings pursuant to such investment transactions. All investment transactions shall be reported to and are subject to (i) authorization or approval by the Board of Directors of the Company properly recorded in the corporate records of the Company, and (ii) any and all applicable regulatory approvals.

Fees for all investment services provided shall be reasonable and shall be computed and settled monthly in accordance with the following schedule of fees: bonds - 5 1/2% of interest income collected; preferred stocks - 5 1/2% of dividends collected; common stocks - quarterly fee of .125% of the market value of the common stock portfolio at the end of the preceding quarter.

Agreement for Legal Services

The Company and Protective Life Corporation entered into an Agreement for Legal Services effective January 20, 2000, under which Protective Life Corporation agreed to provide legal services required by the Company including but not limited to, the following: general corporate legal work, insurance related legal work, contracts, litigation supervision, administrative and other regulatory legal work.

Charges for all legal services shall be the standard rates as promulgated by the Legal Department of Protective Life Corporation from time to time. These rates shall be set forth in a written rate schedule and provided to the Company.

Effective January 1, 2004, the parties entered into a new Agreement for Legal Services that provides that the charges for all legal services shall include all direct and indirect allocable expenses in conformity with customary insurance accounting practices consistently applied payable fifteen days after the end of each calendar quarter.

Agreement for Administrative Services

Effective January 20, 2000, the Company and Protective Life Corporation agreed to include the Company as a participant in an Agreement for Administrative Services dated October 1, 1988. Under this agreement, Protective Life Corporation agrees to provide administrative services as required by members of its holding company system.

The costs of the administrative services shall be shared by members of the holding company system in accordance with generally accepted accounting principles. Such costs shall be accumulated and settled monthly.

Tax Allocation Agreement

Effective January 20, 2000, the Company's federal income tax return is consolidated with the federal income tax returns of its parent, Protective Life Corporation, and its subsidiaries. Federal income taxes are allocated in accordance with a Tax Allocation Agreement dated January 1, 1988, by and between Protective Life Corporation and its subsidiaries.

For each taxable period, each member of the Affiliated Group shall compute its separate tax liability as if it had filed a separate tax return and shall pay such amount. The separate return tax liability of each member shall be computed in a manner consistent with the provisions of Internal Revenue Code Regulation Section 1.1552-1(a)(2)(ii), provided that the carryover of any tax attribute from a prior taxable year, which is not available in determining the consolidated tax liability of the group for such taxable period, shall be disregarded.

Intercompany tax balances are settled not later than the due date for corresponding tax payments or upon receipt of a refund.

In 2004, the Tax Allocation Agreement was amended and restated primarily to clarify the allocation of income taxes to each member. If a member incurs a tax loss or generates a tax credit resulting in a carryforward, the member will not receive credit until the member on a separate return basis can utilize the carryforward. Any such carryforward shall not expire unless such amount is not utilized in the consolidated return.

The Company entered into the following intercompany agreements with other affiliates.

Deposit Agreement

Effective November 1, 2001, the Company entered into a Deposit Agreement with First Protection Corporation under which the Company agrees to invest as part of its investment activity the funds deposited with the Company by First Protection Corporation. The Company will make any deposited funds available to First Protection Corporation within five business days after receiving a written request from First Protection Corporation. The Company will pay interest on the funds at the same rate of return as the Company receives on its overall investment portfolio, net of investment expenses and including capital gains and losses.

Administrative Services Agreement

Effective September 1, 2000, the Company entered into a service contract with Western Diversified Services, Inc. under which Western Diversified Services, Inc. provides administrative services for vehicle service and guaranteed asset protection contracts underwritten by the Company. The services provided include claims processing, commission processing, accounting, legal, compliance, investments, data processing and marketing. Under the agreement, Western Diversified Services, Inc. periodically presents an itemized statement to the Company showing the costs incurred in providing the services. The statement is settled within fifteen days of presentation.

## FIDELITY BOND AND OTHER INSURANCE

The Company is insured on a financial institution bond purchased by its ultimate parent, Protective Life Corporation that provides fidelity coverage with a limit of $75,000,000 and a deductible of $1,500,000. This coverage complies with the suggested minimum amount of fidelity insurance according to NAIC guidelines.

The Company is also insured on policies purchased by its ultimate parent that provide the following coverages:

Commercial property, including building, personal property and business income

Commercial umbrella liability

Commercial umbrella excess liability

Electronic data processing

Business automobile

Workers compensation and employers liability

Fiduciary liability – primary and excess

Errors and omissions - primary and excess

Directors' and officers' liability - primary and excess

Employment practices liability

## PENSION, STOCK OWNERSHIP AND INSURANCE PLANS

The Company has no employees. Required services are provided by affiliates pursuant to the Agreement for Administrative Services described in more detail under "Intercompany Transactions." Employees of affiliates are provided benefits typical of the industry including group health and dental coverage, group life and AD&D insurance, short and long-term disability, pension and profit sharing, vacation and sick leave. The cost of employee benefits including retirement and post employment benefits are included in the intercompany charges from affiliates.

## STATUTORY DEPOSITS

**Deposits with the State of Missouri**

The funds on deposit with the Missouri Department of Insurance as of December 31, 2003, reflected below, were sufficient in par and market value to meet the deposit requirement for the state of Missouri in accordance with Section 379.098 RSMo (Securities Deposits).

| Security | Par Value | Market Value | Statement Value |
|---|---|---|---|
| US Treasury Notes | $ 2,650,000 | $ 2,885,530 | $ 2,757,379 |

**Deposits with Other States**

The Company also has funds on deposit with various other states. Those funds on deposit as of December 31, 2003, were as follows:

| State | Security | Par Value | Market Value | Statement Value |
|---|---|---|---|---|
| Georgia | US Treasury Note | $ 55,000 | $ 61,548 | $ 59,884 |
| Louisiana | US Treasury Note | 50,000 | 53,938 | 51,061 |
| Massachusetts | US Treasury Note | 110,000 | 124,609 | 124,500 |
| New Mexico | US Treasury Note | 350,000 | 396,484 | 396,137 |
| North Carolina | US Treasury Note | 500,000 | 560,000 | 510,552 |
| Oregon | US Treasury Note | 290,000 | 328,515 | 328,228 |
| Virginia | US Treasury Note | 265,000 | 300,195 | 299,932 |
| Total | | $ 1,620,000 | $ 1,825,289 | $ 1,770,294 |

## INSURANCE PRODUCTS AND RELATED PRACTICES

**Territory and Plan of Operations**

The Company is licensed in Missouri under Chapter 379 RSMo (Insurance other than life) to write property, liability, fidelity and surety, accident and health and miscellaneous insurance. The Company is also licensed in the District of Columbia and all states except Maine and New York.

The Company is a member of the Asset Protection Division of Protective Life Corporation (see annual statement for organizational chart). The primary products offered by the Company are vehicle and recreational marine extended service contracts, automobile residual value, surety bonds, guaranteed asset protection, automobile single interest, credit property and inventory protection. Insurance is marketed through a limited number of independent general agents and Company representatives for sale primarily through finance companies, banks and automobile and other retail dealers and is generally serviced by third party administrators.

**Policy Forms & Underwriting; Advertising & Sales Material and Treatment of Policyholders**

The Missouri Department of Insurance has a Market Conduct staff that performs a review of these issues and generates a separate market conduct report. The most recent Missouri Market Conduct Examination was as of December 31, 1991.

The only Market Conduct Examination Report for the period under examination was issued by the California Department of Insurance on June 4, 2004 covering closed claims for the period February 1, 2002 through January 31, 2003. The report did not disclose any issues having a significant impact on the Company's financial position.

# REINSURANCE

## General

Premiums reported during the period under examination were as follows:

| | 2001 | 2002 | 2003 |
|---|---|---|---|
| Direct | $ 205,862,099 | $ 136,195,552 | $ 152,718,533 |
| Assumed | 82,505,812 | 39,998,662 | 42,663,225 |
| Ceded | (202,093,777) | (107,540,486) | (121,144,942) |
| Net Premiums | $ 86,274,134 | $ 68,653,728 | $ 74,236,816 |

## Assumed

Effective December 31, 2000, the Company assumed, on a coinsurance basis, 100% of the in force and future service contract and limited warranty business of its affiliate, Western Diversified Casualty Insurance Company. This agreement was executed to consolidate all the property and casualty business in one company in the Asset Protection Division.

Effective June 28, 2001, the Company assumed a 100% quota share of all losses, loss expenses and refunds reported on or after February 28, 2001 with respect to a contractual liability insurance policy issued by Virginia Surety Company, Inc. to Product Care, Inc. to insure its contractual obligations as obligor under the service contracts. The agreement continues until all amounts payable under the terms and conditions of the policies have been settled.

Effective October 1, 2001, the Company assumed from Insurance Company of the South, an affiliate, 100% of the net retained liability (the liability not ceded to producer owned reinsurance companies) from business administrated by Life of the South Service Company produced under property and casualty policies and certificates issued by Insurance Company of the South in conjunction with credit, sales, financing, leasing, loan or similar transactions by or through financial institutions and dealers.

Effective January 1, 1998, the Company assumed from Lyndon Southern Insurance Company, an affiliate, 50% of the liability from business administrated by Gulfco Insurance Services, Inc., an affiliate, and 100% of the liability from business administered by Life of the South Service Company produced under property and casualty policies and certificates issued by Lyndon Southern Insurance Company in conjunction with credit, sales, financing, leasing, loan or similar transactions by or through financial institutions and dealers.

Assumed premiums during the period being examined and the net payable (including losses, loss adjustment expenses, unearned premiums net of premiums receivable) as of December 31, 2003 under the above contracts were as follows (000's omitted).

| | Assumed Premiums | | | Payable |
|---|---|---|---|---|
| | 2001 | 2002 | 2003 | 12/31/03 |
| Insurance Company of the South | $ 2,105 | 11,870 | 12,972 | 3,090 |
| Lyndon Southern Insurance Company | 7,510 | 8,674 | 9,904 | 4,869 |
| Virginia Surety Company, Inc. | 43,000 | - | - | 9,790 |
| Western Diversified Casualty Ins. Co. | 17,277 | 2,742 | (1,888) | 22,066 |
| All Others | 12,614 | 16,713 | 21,675 | 27,170 |
| | $ 82,506 | 39,999 | 42,663 | 66,985 |

**Ceded**

**London Life International Reinsurance Corporation**

Effective February 1, 2000, the Company ceded to London Life International Reinsurance Corporation, on a coinsurance basis with funds withheld, three blocks of business. The reinsurance transaction was initiated to reduce the statutory impact on Protective Life Insurance Company as a result of its purchase of Lyndon Insurance Group, Inc. Effective January 1, 2001, the agreement was amended to cede a fourth block of business. Effective July 1, 2001, the agreement was amended to add the consumer electronic service contracts assumed by the Company from Virginia Surety Company, Inc. and to exclude any business issued on or after July 1, 2001 from Blocks II and III. Effective June 30, 2003, the agreement was amended to cede a fifth block of business. The business ceded under the agreement as amended is summarized below.

| | |
|---|---|
| | Block I |
| Policies ceded: | All property insurance issued or reinsured by the Company to be retroceded to LOTS Reassurance Company |
| Policy issue dates: | All policies in-force as of February 1, 2000<br>All policies issued on or after February 1, 2000 |
| Quota share: | 100% from the first dollar of coverage |
| | Block II |
| Policies ceded: | All vehicle service contracts issued or reinsured by the Company net of other reinsurance and not included in Block IV below and all consumer electronic service contracts assumed by the Company which were issued by Virginia Surety Company, Inc. and produced through Good Guys stores |
| Policy issue dates: | All vehicle service contracts in-force as of February 1, 2000 and all vehicle service contracts from February 1, 2000 through June 30, 2001 under the same programs as those in existence as of February 1, 2000, and<br>All consumer electronic service contracts assumed by the Company and issued by Virginia Surety Company, Inc. prior to July 1, 2001 |
| Quota share: | 90% from the first dollar of coverage |

Block III

| | |
|---|---|
| Policies ceded: | All other property and casualty insurance issued or reinsured by the Company and not included in Blocks I, II, IV or V net of other reinsurance |
| Policy issue dates: | All policies in-force as of February 1, 2000 and all policies issued from February 1, 2000 through June 30, 2001 under the same programs as those in existence as of February 1, 2000 |
| Quota share: | 90% from the first dollar of coverage |

Block IV

| | |
|---|---|
| Policies ceded: | All vehicle service contracts produced by distribution channels formerly used by Western Diversified Casualty Insurance Company net of other reinsurance and net of warehouse business. |
| Policy issue dates: | All policies issued on or after January 1, 2001 through December 31, 2001 |
| Quota share: | 90% from the first dollar of coverage |

Block V

| | |
|---|---|
| Policies ceded: | All guaranteed automobile protection policies net of other reinsurance |
| Policy issue dates: | All policies in-force as of September 30, 2003 and all policies issued on or after September 30, 2003 |
| Quota share: | 90% from the first dollar of coverage |

**LOTS Reassurance Company, LTD**

Effective April 1, 2000, the Company ceded to LOTS Reassurance Company, LTD. under a 100% quota share contract the contractual automobile liability business produced under a service contract between Life of the South Insurance Company and Acceleration National Service Corporation.

**Dublin International, LTD.**

Effective July 1, 1998, the Company ceded to Dublin International, LTD. (Dublin), an affiliate, 100% of the liability on vehicle service and guaranteed automobile protection contracts. This liability is then retroceded to producer owned reinsurance companies (PORCs). On or before the fortieth day following month end, the Company shall furnish the reinsurer a summary report of the monthly activity including reinsurance premiums less claims and applicable ceding fee and taxes. If funds are due the reinsurer, the Company shall remit the funds to the custodial account the reinsurer established for the benefit of the Company. The reinsurer shall maintain the account as required under Missouri law in regard to the risks reinsured under the agreement. If the summary report indicates a balance is due the Company, the reinsurer shall remit the funds directly to the Company within ten days.

Dublin is not an authorized reinsurer in Missouri. On December 31, 2003, the reserve credits were secured by Trust Funds funded by the PORCs that name the Company as the primary beneficiary. The letter of credit issued pursuant to the stop loss treaty described below is also used to secure the reserve credits.

The Company reported on Schedule F, Parts 3 & 5, a negative ceded balance payable of $4,021,000 from Dublin. Subsequently, the Company stated that this balance should have been recorded as a receivable from Acceleration National Service Company. However, the Company was unable to provide a definitive explanation as to what transaction initiated the balance. Documentation was provided suggesting that the balance was settled on February 27, 2004. This settlement showed that the Company received $4,021,000 from Dublin and paid Acceleration National Service Company $2,667,503. Because the receivable balance appears to be unsecured, the Provision for Reinsurance was increased by $4,021,000.

**Dealer Services Reinsurance, LTD.**

Effective January 1, 2002, the Company ceded to Dealer Services Reinsurance, LTD., an affiliate, (Formerly Western Diversified Accident and Health, LTD.) 100% of the vehicle service and guaranteed automobile protection contracts that are then retroceded to various PORCs. On or before the fortieth day following month end, the Company shall furnish the reinsurer a summary report of the monthly activity including reinsurance premiums less claims and applicable ceding fee and taxes. If funds are due the reinsurer, the Company shall remit the funds to the custodial account the reinsurer established for the benefit of the Company. The reinsurer shall maintain the account as required under Missouri law in regard to the risks reinsured under the agreement. If the summary report indicates a balance is due the Company, the reinsurer shall remit the funds directly to the Company within ten days.

Dealer Services Reinsurance, LTD. is not an authorized reinsurer in Missouri. On December 31, 2003, the reserve credits were secured by Trust Funds and letters of credit funded by the PORCs that name the Company as the primary beneficiary and by Funds Held by the Company under reinsurance treaties. The letter of credit issued pursuant to the stop loss treaty described below is also used to secure the reserve credits.

As noted above, the reinsurance agreements with Dublin International, LTD. and Dealer Services Reinsurance, LTD. require the reinsurers to establish custodial accounts for the benefit of the Company and specify that the Company will remit funds due the reinsurers to the custodial accounts. The agreements require the reinsurers maintain the custodial accounts as required by Missouri law in regard to the risks reinsured under the agreements. The custodial accounts have not been established and no funds have been maintained in the custodial accounts.

**London Life and Casualty Reinsurance Corporation**

Effective December 31, 2000, the Company entered into a stop loss treaty with London Life and Casualty Reinsurance Corporation. The treaty, as amended, provides for stop loss benefits and a letter of credit. The reinsurance contract applies only to that portion of insurance on reinsured policies and not to any portion retained by the Company for its own account. The stop loss coverage is for four years duration commencing on either the date the Company elects to initiate the first period of coverage or the date the Company draws upon the letter of credit. Additional annual premiums of $620,000 are payable for each of the four years of the stop loss coverage. The attachment point is a 155% loss ratio for all business reinsured under the treaty for a one-year period consisting of twelve consecutive months. The coverage period begins on the date initiated and is effective through each of the three subsequent anniversaries. Under the contract, the reinsurer agrees to provide a clean, irrevocable, unconditional and evergreen letter of credit in the amount of $12,400,000. The scheduled expiration date of the agreement is after the four consecutive periods of stop loss coverage. The Company, with thirty days notice, can terminate the contract at any time prior to the commencement of the stop loss coverage. After commencement of the stop loss coverage, the Company can terminate the contract at any time by paying all the outstanding premiums due before the scheduled expiration date. The reinsurer, with ninety days notice, can terminate the contract at any time before the commencement of the stop loss coverage on the anniversary date of each treaty year.

Because protection provided by this reinsurance cannot be obtained without payment of the scheduled premiums (payments total $2,480,000), the Provision for Reinsurance is increased by the amount of the premium.

**Summary**

Ceded premiums during the period being examined and the net recoverable (including losses, loss adjustment expenses, unearned premiums net of ceded balances payable) as of December 31, 2003 under the above contracts were as follows (000's omitted). The PORC category below includes the business retroceded by Dublin International, LTD. and Dealer Services Reinsurance, LTD. as well as the business ceded to other PORCs by the Company.

| | Ceded Premiums | | | Recoverable |
|---|---|---|---|---|
| | 2001 | 2002 | 2003 | 12/31/03 |
| London Life International Reins. Corp. | $136,509 | 29,574 | 35,940 | 104,613 |
| Lots Reassurance Company | 1,429 | 2,271 | 3,543 | 5,472 |
| PORCs | 48,336 | 57,575 | 76,311 | 107,829 |
| London Life & Casualty Reins. Corp. | 137 | 191 | 310 | 0 |
| All Others | 15,683 | 17,929 | 5,041 | 21,795 |
| | $202,094 | 107,540 | 121,145 | 239,709 |

## ACCOUNTS AND RECORDS

The Company's financial statements were audited PricewaterhouseCoopers LLP, Certified Public Accountants. Reserves and related actuarial items were reviewed and certified by Wayne Holdredge, A.C.A.S., M.A.A.A., associated with the firm of Tillinghast-Towers Perrin, Consulting Actuaries.

**Custodial Agreements**

The Company made inaccurate disclosures with respect to its securities custodians. The Company should disclose, in Question 23.01 of the General Interrogatories of the annual statement, all custodial agreements that comply with the requirements of the NAIC Financial Condition Examiners Handbook. Requirements in the Handbook include, among other things:

- a provision requiring the custodian to indemnify the company in the event securities are lost or stolen,
- a provision requiring the custodian to notify the domiciliary insurance department if the agreement is terminated or if all securities are removed from the account,
- a provision that grants the insurance company the right to inspect the institution's records relating to securities,
- a provision requiring the custodian to maintain adequate insurance coverage.

The Company listed agreements with five institutions as complying with the Handbook. However, two agreements did not contain all the necessary provisions. Those were agreements with the Bank of New York and Royal Bank of Canada. In addition, two others should not have been shown; US Bank (where cash accounts are maintained) and Institutional Brokerage Services (no securities were held there at December 31, 2003 and the account was subsequently terminated.) The agreement with Central Bank was adequate.

The Company should require that agreements with Bank of New York and Royal Bank of Canada contain all the necessary provisions to be consistent with the requirements of the Financial Condition Examiners Handbook. Otherwise, those agreements that do not comply should be disclosed in the General Interrogatories under question 23.02 along with explanations why the agreements don't comply.

**Uncollected Premiums and Agents' Balances**

The Administrative Agreement with Cumberland Surety, Inc. requires that premiums be remitted to the Company within 45 days of the month written. The Company did not receive the October 2003 premiums until January 2004. The Company should take actions to ensure that the payment terms of the agreements with producers are met in a timely manner.

The company failed to provide requested reports showing the aging of receivables or an analysis of the collectibility of those receivables. This is necessary to comply with SSAP 6, which requires charging off receivables deemed uncollectible. The company should implement controls that would ensure records, showing the aging of receivables and an analysis of the collectibility of those receivables, are available for review during financial examinations.

## FINANCIAL STATEMENTS

The following financial statements, with supporting exhibits, present the financial condition of the Company as of December 31, 2003, and the results of operations for the year then ended. Any examination adjustments to the amounts reported in the annual statement and/or comments regarding such are made in the "Notes to the Financial Statements," which follow the Financial Statements.

There may have been additional differences found in the course of this examination, which are not shown in the "Notes to the Financial Statements." These differences were determined to be immaterial in relation to the financial statements, and therefore were only communicated to the Company and noted in the workpapers for each individual annual statement item.

## ASSETS

| | Assets | Assets Not Admitted | Net Admitted Assets |
|---|---|---|---|
| Bonds | $ 271,820,704 | $ - | $ 271,820,704 |
| Preferred stocks | 3,240,559 | - | 3,240,559 |
| Common stocks | 34,968,327 | - | 34,968,327 |
| Cash and short-term investments | 64,997,812 | - | 64,997,812 |
| Other invested assets | 15,488 | - | 15,488 |
| Investment income due and accrued | 3,699,215 | - | 3,699,215 |
| Uncollected premiums and agents' balances | 4,393,277 | - | 4,393,277 |
| Amounts recoverable from reinsurers | 7,898,611 | - | 7,898,611 |
| Net deferred income tax asset | 14,441,268 | 8,537,856 | 5,903,412 |
| Electronic data processing equipment and software | 33,996 | 33,996 | - |
| Furniture and equipment | 629,524 | 629,524 | - |
| Net adjustment in assets and liabilities due to foreign exchange rates | 561,517 | - | 561,517 |
| Receivable from parent, subsidiaries and affiliates | 1,452,481 | - | 1,452,481 |
| Deposits and other prepaid items | 632,352 | 632,352 | - |
| Totals | $ 408,785,131 | $ 9,833,728 | $ 398,951,403 |

## LIABILITIES, SURPLUS AND OTHER FUNDS

| | |
|---|---|
| Losses | $ 12,667,997 |
| Reinsurance payable on paid loss and loss adjustment expenses | 594,531 |
| Loss adjustment expenses | 170,524 |
| Commissions payable, contingent commissions and similar charges | 2,368,066 |
| Other expenses | 2,607,317 |
| Taxes, licenses and fees | 1,539,927 |
| Unearned premiums | 127,087,885 |
| Ceded reinsurance premiums payable | 1,272,248 |
| Funds held by company under reinsurance treaties | 78,045,610 |
| Provision for reinsurance (Note 1) | 7,376,000 |
| Payable to parent, subsidiaries and affiliates | 18,202,342 |
| Payable for securities | 34,744 |
| Escheatable property | 226,111 |
| Total liabilities | 252,193,299 |
| Common capital stock | $ 4,000,000 |
| Gross paid in and contributed surplus | 52,708,443 |
| Unassigned funds | 90,049,661 |
| Surplus as regards policyholders | 146,758,104 |
| Totals | $398,951,403 |

## STATEMENT OF INCOME

| | |
|---|---|
| Premiums earned | $ 69,342,320 |
| Losses incurred | 55,198,921 |
| Loss expenses incurred | 1,509,818 |
| Other underwriting expenses incurred | 33,863,813 |
| Total underwriting deductions | 90,572,552 |
| Net underwriting gain (loss) | (21,230,232) |
| Net investment income earned | 16,733,916 |
| Net realized capital gain or (losses) | 5,911,483 |
| Net investment gain (loss) | 22,645,399 |
| Net income before federal and foreign income taxes | 1,415,167 |
| Federal and foreign income taxes incurred | (628) |
| Net income | $ 1,415,795 |

## CAPITAL AND SURPLUS ACCOUNT

| | |
|---|---|
| Surplus as regards policyholders, beginning of year | $ 143,761,046 |
| Net income | 1,415,795 |
| Change in net unrealized capital gains or (losses) | (9,550) |
| Change in net unrealized foreign exchange capital gain (loss) | 1,253,470 |
| Change in net deferred income tax | 2,889,042 |
| Change in nonadmitted assets | (1,007,674) |
| Change in provision for reinsurance | 1,031,000 |
| Surplus adjustment paid in | 4,341,975 |
| Cumulative effect of examination changes (Note 1) | (6,917,000) |
| Change in surplus as regards policyholders for the year | 2,997,058 |
| Surplus as regards policyholders, end of year | $ 146,758,104 |

## NOTES TO FINANCIAL STATEMENTS

Note 1 Provision for Reinsurance $7,376,000

The Provision for Reinsurance was increased by $6,917,000.

Under the stop loss reinsurance treaty described on page 27, four additional annual premium payments of $620,000 are due if the Company draws on the letter of credit provided under the reinsurance treaty. The Provision for Reinsurance was increased by $2,480,000 to reflect the required additional premium payments.

The Company reported a $4,021,000 ceded reinsurance premium receivable from Dublin International, LTD. as described on page 26. However, the Company could not demonstrate that this receivable was secured.

The Company recalculated the provision during the examination resulting in a $416,000 increase in the provision.

## EXAMINATION CHANGES

| | | | |
|---|---|---|---|
| Total surplus per annual statement: | | | |
| Common capital stock | | $ 4,000,000 | |
| Gross paid in and contributed surplus | | 52,708,443 | |
| Unassigned surplus | | 96,966,661 | |
| | | | $ 153,675,104 |
| | Increase In Surplus | Decrease In Surplus | |
| Assets: | | | |
| | $ - | $ - | |
| Total | $ - | $ - | |
| Liabilities: | | | |
| Provision for reinsurance (Note 1) | $ - | $ 6,917,000 | |
| Total | $ - | $ 6,917,000 | |
| Net Change | $ - | $ 6,917,000 | (6,917,000) |
| Total surplus per examination report: | | | |
| Common capital stock | | $ 4,000,000 | |
| Preferred capital stock | | 52,708,443 | |
| Gross paid in and contributed surplus | | 90,049,661 | |
| Surplus as regards policyholders | | | $ 146,758,104 |

## GENERAL COMMENTS AND/OR RECOMMENDATIONS

**Reinsurance Ceded** Page 24

The Company and its affiliates should review their practices and procedures to ensure that funds are promptly collected, disbursed and recorded correctly. The annual statement including Schedule F should be completed in accordance with the Accounting Practices and Procedures Manual and Annual Statement Instructions. The data necessary to complete the statutory examination must be readily available.

In addition, the custodial accounts be should established and maintained as required under the reinsurance agreements.

**Custodial Agreements** Page 29

The Company should require that agreements with Bank of New York and Royal Bank of Canada contain all the necessary provisions to be consistent with the requirements of the Financial Condition Examiners Handbook. Otherwise, those agreements that do not comply should be disclosed in the General Interrogatories under question 23.02 along with explanations why the agreements don't comply.

**Uncollected Premiums and Agents' Balances** Page 30

The Company should take actions to ensure that the payment terms of the agreements with producers are met in a timely manner.

The company should implement controls that would ensure records, showing the aging of receivables and an analysis of the collectibility of those receivables, are available for review during financial examinations.

## SUBSEQUENT EVENTS

None.

## ACKNOWLEDGMENT

The assistance and cooperation extended by the officers and the employees of Lyndon Property Insurance Company and its affiliates during the course of this examination is hereby acknowledged and appreciated. In addition to the undersigned, Walter A. Riesenberg, CPA, CFE and Daniel P. Callahan, CPA, CFE, examiners for the Missouri Department of Insurance, participated in this examination. Jon W. Michelson, FCSA, MAAA, associated with Expert Actuarial Services, LLC, reviewed the reserves and related actuarial items.

## VERIFICATION

State of Missouri )
) ss
County of Cole )

I, Robert P. Jordan, on my oath swear that to the best of my knowledge and belief the above examination report is true and accurate and is comprised of only facts appearing upon the books, records or other documents of the Company, its agents or other persons examined or as ascertained from the testimony of its officers or agents or other persons examined concerning its affairs and such conclusions and recommendations as the examiners find reasonably warranted from the facts.

Robert P. Jordan

Robert P. Jordan, CFE
Examiner-in-Charge
Missouri Department of Insurance

Sworn to and subscribed before me this 5th day of October, 2005.
My commission expires:

JACQUELINE A. GREEN
Notary Public - Notary Seal
STATE OF MISSOURI
St. Louis County
My Commission Expires March 22, 2008

Jacqueline A. Green
Notary Public

## SUPERVISION

The examination process has been monitored and supervised by the undersigned. The examination report and supporting workpapers have been reviewed and approved. Compliance with NAIC procedures and guidelines as contained in the Financial Condition Examiners Handbook has been confirmed.

Christiana Dugopolski

Christiana Dugopolski, CFE, CPA
Audit Manager, St. Louis
Missouri Department of Insurance

**Asset Protection Division**
One Chesterfield Place
14755 North Outer Forty Road, Suite 400
Chesterfield, MO 63017
636-536-5600 / 800-950-6060

Protective

January 18, 2006
Kirk Schmidt, CFE, CPA
Chief Financial Examiner
State of Missouri
Department of Insurance
P O Box 690
Jefferson City, MO 65102-0690

RECEIVED
MO INS DEPT
JAN 19 2006

Dear Mr. Schmidt:

Below is our official response to be included in the financial report of Lyndon Property Insurance Company:

**Item 1.**
The report states on Page 26:
*The Company reported on Schedule F, Parts 3 & 5, a negative ceded balance payable of $4,021,000 from Dublin. Subsequently, the Company stated that this balance should have been recorded as a receivable from Acceleration National Service Company (ANSC). However, the Company was unable to provide a definitive explanation as to what transaction initiated the balance. Documentation was provided suggesting that the balance was settled on February 27, 2004. This settlement showed that the Company received $4,021,000 from Dublin and paid ANSC $2,667,503. Because the receivable balance appears to be unsecured, the Provision for Reinsurance was increased by $4,021,000.*

Documentation was provided that described the flow of funds and ultimate settlement of intercompany balances. The amount reported on Schedule F as a receivable from Dublin was a clerical error as the receivable was actually from another affiliate, ANSC, a service contract administration company not reflected in Schedule F.

The error was the result of the following:
Western Diversified Services (WDS), an affiliate, collects funds on behalf of Lyndon Property Insurance Company (LPIC) and ANSC related to service contract business. Prior to year end 2003, WDS transferred the service contract premium to LPIC, who in turn sent the ceded portion of the funds to Dublin. The ANSC portion of these funds were inadvertently recorded as a receivable from Dublin, instead of offsetting a payable to ANSC.

The intercompany balances were settled in the first quarter 2004. Beginning with the third quarter of 2005, WDS is making separate wire settlements to LPIC and ANSC.

Thank you for your time in reviewing our concerns.

Sincerely,

Mark S. Downar
Vice President